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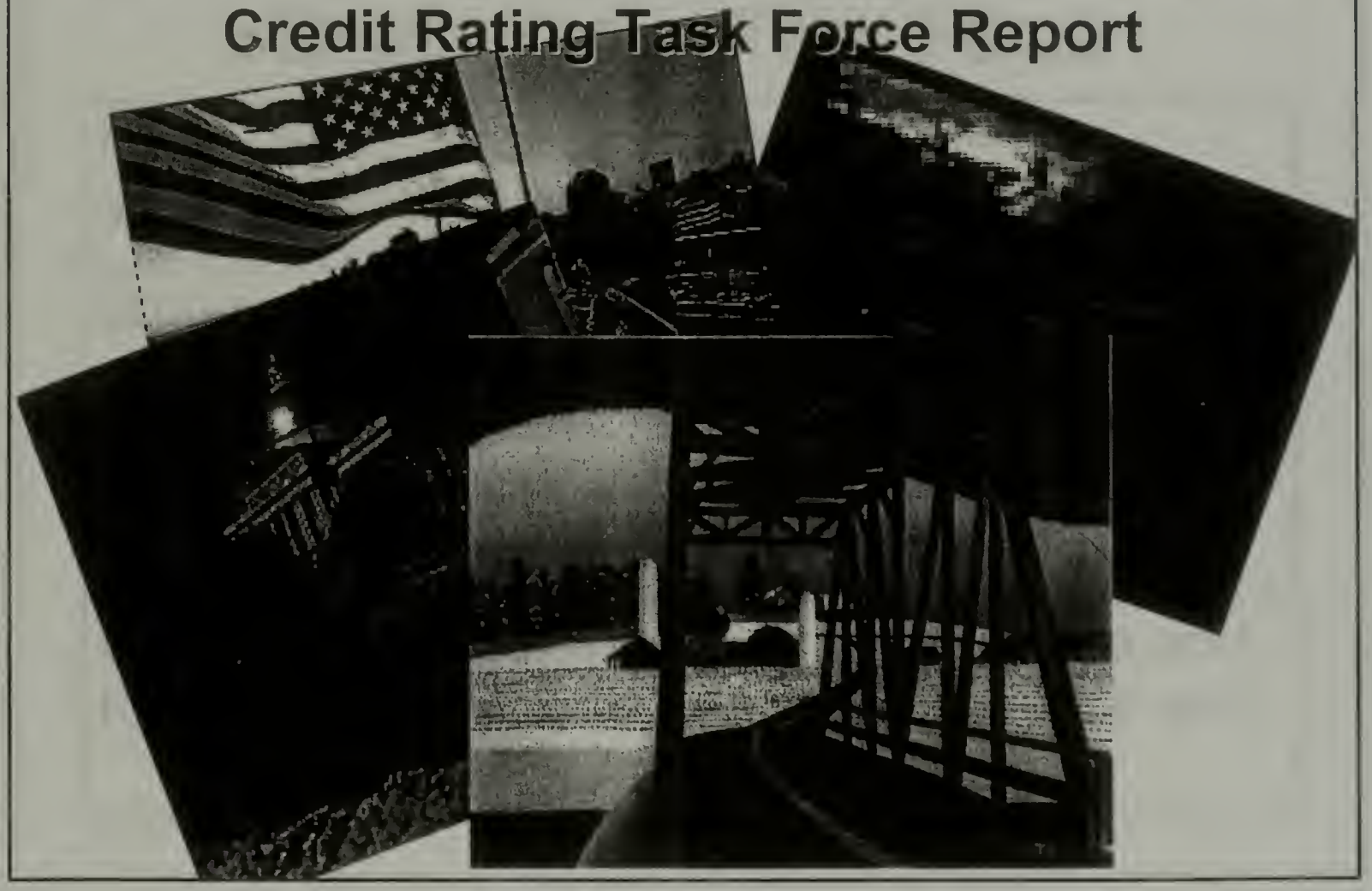
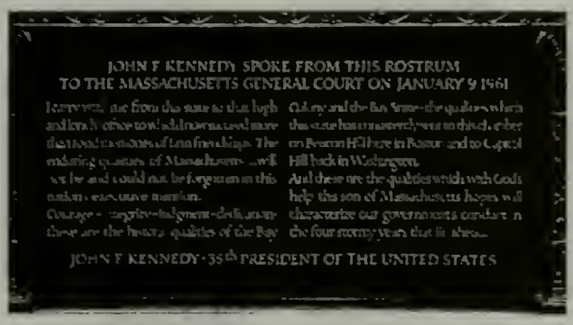
Massachusetts House of Representatives
Credit Rating Task Force Report



Recommendations
Credit Rating Task Force

Match Revenues against Expenses	Create Structural Balance
Show a realistic, evidence-backed plan	Tobacco Bonds value is dubious long term
Avoid Gimmicks Avoid One-shot Deals	Save now for next rainy day
Deficit Financing: Risky and Expensive	Evaluate details and exit strategy for any new borrowing

"courage, integrity, judgment and dedication- the qualities… sent to this chamber (to prevail against) …the stormy years that lie ahead."


JOHN F KENNEDY SPOKE FROM THIS ROSTRUM
TO THE MASSACHUSETTS GENERAL COURT ON JANUARY 9 1961
JOHN F KENNEDY · 35th PRESIDENT OF THE UNITED STATES

The Credit Rating Task Force

- On behalf of Representative Parente, Representative Wagner, and all the honorable members of our respective committees we thank you for your attention and support,

Rep. James H. Fagan, chairman
House Post Audit and Oversight Committee

Rep. Joseph W Wagner, chairman
Committee on Transportation

Rep. Marie J. Parente, chairman
House Committee on Long Term Debt

CRTF Seminar participants

- Treasurer of the Commonwealth
- Executive Office of Administration and Finance
- Comptroller of the Commonwealth
- Fitch Ratings
- Standard and Poor's Corp.
- MassPort, MBTA, MassPike;
- Federal Reserve Bank of Boston;
- Several Investment banks
- Massachusetts Taxpayers Foundation

Members of the CRTF

- House Committee on Post Audit and Oversight
- House Committee on Transportation
- House Committee on Long Term Debt

Misery versus Happiness
Don't spend more than you earn

- **"My other advice, Copperfield," said Mr. Micawber, "you know. Annual income twenty pounds, annual expenditure nineteen, nineteen six, result happiness.**
- **"Annual income twenty pounds, annual expenditure twenty pounds, ought and six, result misery**
- **...in short, you are for ever floored. As I am!"**

Massachusetts House of Representatives

Doing Its Job

- "No one is watching their credit rating better than the Massachusetts House of Representatives, certainly (the leader) in the Northeast." - national credit rating agency

Good Management
Important Ratings Assessments

- Some states take actions and **hope** that things get better; this is not a good strategy.
- Rating agencies assess a state's management by credible evidence:

1. What is the strategy/plan?
2. Will it work?
3. What and where is the proof?

Put it on my bill

- A duck walks into a bar and orders a drink.
- The bartender says fine, but how are you going to pay for this drink?
- The duck says:

  Put it on my bill!

The Credit Card is "max-ed" out

"Daddy, does this mean we're poor now?"

Massachusetts:
Wealthy state but deeply indebted

- First "snap shot" for credit rating agencies is gross personal income and its relation to overall state debt
- Massachusetts income to debt ratio is 9 percent
- **Rating agencies danger zone is 10 percent income/debt ratio**

Formula for 9 %

- Fitch Ratings assess a state's debt position by dividing the total state debt (Mass. = $22.7 billion) by the gross personal income (Mass. = $248.2 billion) to achieve a ratio.

- Mass. debt to income ratio is 9.1 percent

Fitch Ratings of New England States

Connecticut	AA
Maine	AA+
Massachusetts	AA-
New Hampshire	AA+
Rhode Island	AA
Vermont	AA+

Credit Rating Agencies: The Umpire Strikes Back

- Downgrades follow bad judgments
- Credit Rating Agencies sort out the structurally balanced plans from schemes, gimmicks, and one-shot deals.

S&P Ratings for New England States

Connecticut	AA
Maine	AA+
Massachusetts	AA-
New Hampshire	AA+
Rhode Island	AA-
Vermont	AA+

The Rating Agencies View of Massachusetts "G-O" Debt

Fitch Ratings	AA-	Negative outlook
Standard and Poor's (S&P)	AA-	Stable Outlook
Moody's Investor Service	Aa2	Negative outlook

Moody's New England state debt ratings

- Conn. = Aa2 negative outlook and negative watch list
- Maine = Aa2 stable outlook
- Mass. = Aa2 negative outlook
- N.H. = Aa2 stable outlook
- R.I. = Aa3 stable outlook
- VT = Aa1 stable

• Ratings per Moody's Investor Service

Fitch Ratings Criteria

- Assess the wealth of Massachusetts, especially its gross personal income.
- Positive: Massachusetts' economic resources
- Negative: Massachusetts' high debt to personal income

Fitch Evaluation of Mass.

- Massachusetts is in trouble due to:
- Deteriorating economic conditions
- Drop in personal income
- No substantial reserves remain
- New pressure to increase contributions to the pension
- Solution: Either raise revenue, or cut expenses

Standard and Poor's Rating Criteria

- Rating is an opinion of the state's ability to repay its debt
- The main issue for Massachusetts rating stress is its high debt load
- Avoid one-time quick fixes and gimmicks
- Debt downgrade would result from a sustained, structural budget imbalance (excessive expenses against insufficient revenues)

Standard and Poor's Evaluation

- Multiple economic problems.
- Both different and more difficult to solve the problem this year;
- Economic salvation may require breaking some rules of credit rating; the key is picking the appropriate rules to break.
- Ratings depend upon a credible plan!

Standard and Poor's Evaluation

- Massachusetts has a history as a volatile financial environment because of its "cutting edge" product and production in "high technology" manufacturing and services;
- Consequently, if computer sales, service and support show weak demand, the Massachusetts economy is in trouble.

S&P Rating = AA- with stable outlook

- The primary reason Massachusetts has any negative aspect to its rating is the state's high debt load
- Depending on the criterion Massachusetts is either second or third in the nation in its accumulated debt. Hawaii is first. CT may be 2nd.

Pay me now, or pay me later

- Credit rating agencies Fitch, Standard and Poor's and Moody's pass judgment on state's borrowing; ability to repay; ability to obtain money in the future at favorable rates; and appetite to raise necessary revenue, or will to cut expenses.
- Massachusetts gets good grades for its sound legislative judgment last year

Can't predict the future

- Chief financial officers are increasingly worried about the economy's prospects.
- In a survey of 186 finance officers last week by Financial Executives International and Duke University, **45 percent said they felt less optimistic. Three months earlier, only 15 percent said that.**

'HARSH WINTER OPENING HOLES IN LOCAL BUDGETS AS WELL AS ROADS'

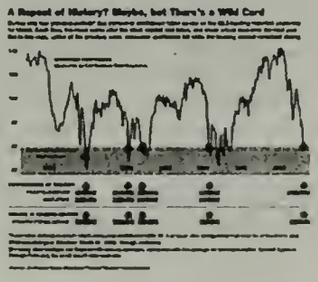
- 'I haven't seen it this bad in more than a decade'
- This year's record snowfall and extreme cold have exacerbated the (pothole) problem.
- In Boston, the tab for patching potholes is also more than twice what it was last year.

Riders on the Storm

- **Boston-area job losses among most severe in US** - Boston Globe, Business Section, Thursday, March 27, 2003
- **Home Sales and Orders to Factories Show Declines**
- WASHINGTON, March 26 - By THE ASSOCIATED PRESS — Sales of new single-family homes plunged to the lowest level in nearly three years in February, while manufacturing demand weakened, according to two reports released by the Commerce Department today.
- "We saw the negative effects of bad weather, worries about an impending war with Iraq, an increase in oil prices and a decline in the stock market."

Increasing Uncertainty Provokes a Flight to Quality

- New York Times reports that the consumer confidence level is the lowest in 10 years, and the fourth lowest level in over 3 decades
- Be Prepared



Keep Massachusetts a quality place to live and work

- Protect Massachusetts credit rating
- Avoid the collapse that accompanied the recession of the 1990s and reduced Mass. bonds to junk status

Threats to Mass Credit Rating

- Structural deficit and no plan (expenses exceeding revenue)
- Tobacco settlement uncertainty
- Assuming other big debts:
  - MassPike - $2.5 billion
  - Pension - $16 billion
  - Tobacco – Unknown??
- Deficit Finance

Tobacco Money:
Take another little piece of my heart

- Tobacco bonds are not tax exempt!
- Tobacco settlement under assault.
- States issuing debt bear ultimate responsibility for repayment!
- Rhode Island only New England state to issue Tobacco bonds

Threat to Tobacco bonds

- The State of Virginia delayed the closing of a $767 million tobacco bond sale ... after the ratings on $18 billion in similar bonds were cut by Moody's Investors Service...Because Moody's reduced the rating to A3 from A1 on the Virginia issue, the lead underwriter, Morgan Stanley, told the state it could not close the sale. .. "This was sold as an A1, and it is now an A3 and that is a material change," said Jody Wagner, the treasurer of Virginia ...

Threat to Tobacco bonds

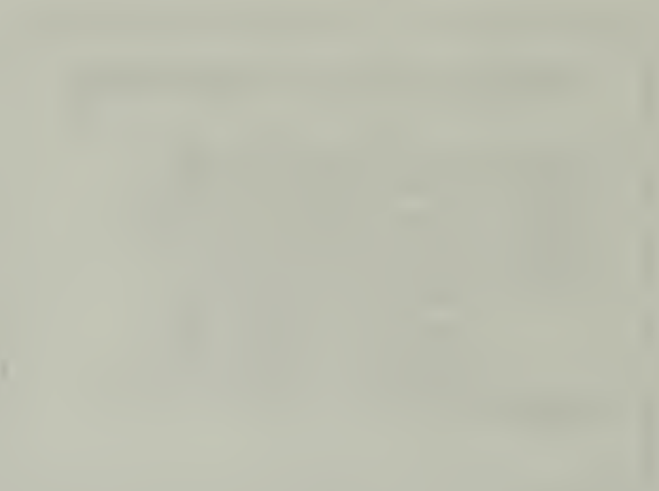
- "Fitch Ratings Places Approx. $18B of Tobacco Bonds on Rating Watch Negative ... all of its outstanding tobacco settlement securitization ratings on Rating Watch Negative... The action on the tobacco related secutitizations reflects the potential for increased industry risk as result of the same factors influencing Altria Group's credit profile. Altria is the parent of Philip Morris USA, Inc.

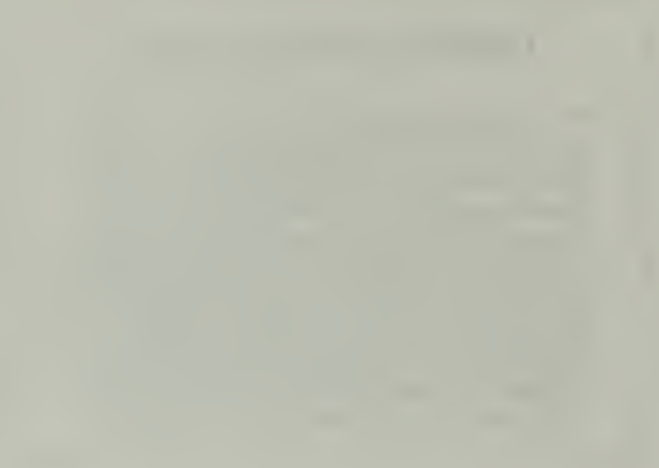
Tobacco Money: Up in Smoke?

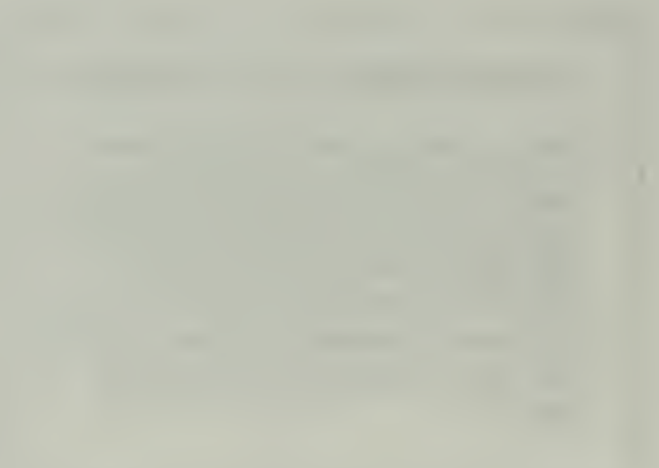
- More important, a spokesman for Eliot Spitzer, the New York Attorney General said, any tinkering with the fee arrangement could result in tinkering with the overall (tobacco) settlement. "We argue against reopening it in part because disrupting it right now could have serious financial consequences," he said.
- "It would compound a fiscal problem facing local governments and the state."

Success story for credit rating
Massachusetts Bay Transit Authority

- **Forward funding a positive factor in the MBTA credit rating**
- **The MBTA as a stand alone agency offers rating agencies a level of "transparency" in judging the ability to pay its debt and operate its system.**







Massachusetts Turnpike Authority: No one asked the bond counsel!

- Who Knew? Administration never approached MassPike Bond Counsel.
- MassPike Bond Counsel cautions any bond conversion will be complicated.

MassPike

- **There are no savings here. Any monies taken must be repaid and that results in more costs long term. That cost is possibly as large as $400 million over the life of the debt.**
- **MassPike Bond Counsel cautions any bond conversion will be complicated and potentially costly to the Commonwealth and bondholders.**
- **Credit Raters question: what to expect from re-organized MassPike? MassHighway?**
- **No known answer to that question**

MassPike: Revenue Bonds

- **The bondholders' payments are "secured" by the toll revenue. SJC decision confirms the MassPike Bond Covenant.**
- **GO bond conversion make Pike tolls potential one-time revenue**

Tolls & MassPike Revenue Bonds

Converted to General Obligation (GO Debt)

- Administration: Convert tolls to General Fund
- Tolls become Legislative concern
- Toll inaction causes bond raters to downgrade GO debt

Mass. Convention Center Authority

- Taking $100 million from the $160 million convention center fund to cover other state operating expenses is shortsighted
- ***$160 million in Convention Center Fund Needed for Future of the Project***
- ***Boston Convention Center Power Plant – $50 to $100 million Additional Authorization Needed to Build the Center***

Mass. Convention Center

- Convention Center Fund fed from proceeds of hotel taxes.
- Business travel down substantially per MassPort

FYO4 Pension issues: Another perfect storm

- Pension continued to lose value in FY03
- Unfunded liability has grown due to:

1. Increased benefits
2. appropriation decrease
3. Investment return
4. Asset liquidation

Preserve pension system with a thoughtful, long term plan

- Extend full funding liability schedule to original date of 2028
- No expected adverse credit rating impact
- Create ad hoc legislative task force to analyze MGL Chap. 32, benefit levels, employee contribution, and pension obligation bond (POB) feasibility.

Real Estate Pension Funding: Structural Balance or Bridge to Nowhere

- **House 1 appropriation insufficient to reach either 2023 or 2028 funding schedule**
- **Does PRIM -pension mgt. board- have real estate expertise?**
- **Is this a one shot?**
- **Actual value of the land?**

Mass. Taxpayers Foundation

- <u>Revenue Options: High Political Risk</u>
- Increase state sales tax
  - Mass. sales tax among lowest nationally
  - Each penny increase returns $700 million revenue
- Adjust percentage of income tax
  - Upward adjustment from 5.3 percent
  - Each upward adjustment of the percent equals $150 million
  - Thus: a return to 5.6 percent equals $450 million in revenue
- Deficit Financing with safeguards

Pension Obligation Bonds (POB): Solution or Quagmire?

- **POB would fully fund the system.**
- **Huge state debt increase to $12 – 16 billion.**
- **No return guaranteed on investment**
- **If benefits change, unfunded liability returns**

Mass. Taxpayers Foundation: "Dire Situation"

- "Never thought we'd be putting revenues and deficit financing on the table (for consideration) but that's how dire we think the situation is"

  - Mass Taxpayers Foundation President

- Deficit Financing with three provisos:

1. Part of multi-year plan
2. Be limited In borrowed amount
3. Short repayment schedule

The Escalating Bill: How Much Debt?

$2.5 Billion?	State assumes Mass Pike Debt
$12-16 Billion?	State assumes Pension obligation to fully fund retirement
$21 billion	Current State "core" debt
$39 billion +	Ever Escalating Grand Total

More Questions than Answers

- How difficult and expensive will it be to "unwind" and consolidate the MassPike bonds?
- What pressures will result from pension shortfalls, or pension obligation bonds?
- Quick fixes often create unforeseen, long-term, expensive problems
- What is the exit strategy?

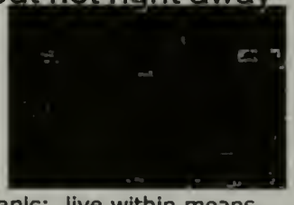
Who Pays?

- More Massachusetts debt service payment for borrowed money means less money for state programs in all times; good or bad
- All program reductions due to increased debt service will be directly felt by businesspeople, students, the elderly, the poor, teachers, police, firefighters, homeowners, the homeless, or in short, by everyone in Massachusetts.

Which programs are sacrificed to a growing state debt?

- More Massachusetts debt means the end of other state programs!
- Which ones do we sacrifice?

Better days are coming… … but not right away

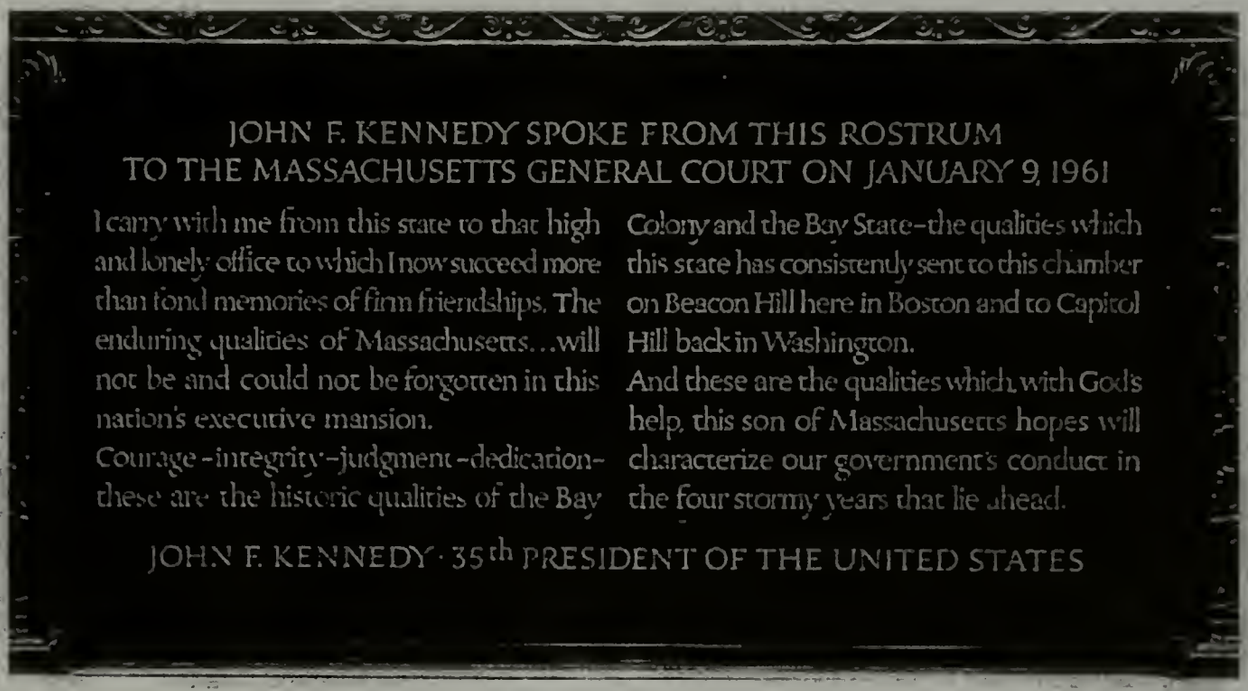


- Stay the course; don't panic; live within means
- Keep state debt manageable – under 10%
- Don't do gimmicks, or one time cash grabs
- Protect Massachusetts Credit Rating

Seize inspiration from our very chamber – the Massachusetts the House of Representatives

Let us take our inspiration in this difficult task from those "qualities of Massachusetts" listed on the rostrum of our chamber and spoken to our forebears over four decades ago – "courage, integrity, judgment and dedication …"

"courage, integrity, judgment and dedication- the qualities… sent to this chamber (to prevail against) …the stormy years that lie ahead."


JOHN F. KENNEDY SPOKE FROM THIS ROSTRUM
TO THE MASSACHUSETTS GENERAL COURT ON JANUARY 9, 1961
I carry with me from this state to that high and lonely office to which I now succeed more than fond memories of firm friendships. The enduring qualities of Massachusetts…will not be and could not be forgotten in this nation's executive mansion.
Courage-integrity-judgment-dedication- these are the historic qualities of the Bay Colony and the Bay State-the qualities which this state has consistently sent to this chamber on Beacon Hill here in Boston and to Capitol Hill back in Washington.
And these are the qualities which, with God's help, this son of Massachusetts hopes will characterize our government's conduct in the four stormy years that lie ahead.
JOHN F. KENNEDY · 35th PRESIDENT OF THE UNITED STATES